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Accountant and Attorney Liability as "Sellers" of Securities under Section 12(2) of the Securities Act of 1933: Judicial Rejection of the Statutory, Collateral Participant Status Cause of Action

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I. INTRODUCTION

The Securities Act of 1933¹ regulates the initial disclosure of information regarding the sale and transfer of securities. This statute, along with the Securities Exchange Act of 1934,² was enacted to serve as a deterrent to fraud in securities transactions. The remedial nature of the statute was accentuated by the statute's mandated disclosure of certain information in order to protect investors from unscrupulous securities promoters.³

Section 12 of the 1933 Act establishes a cause of action that can be brought by a purchaser against a seller who has acted in violation of the statute.⁴ This cause of action provides for a rescission of any se-

1. 15 U.S.C. §§ 78a-78aa (1988)[hereinafter "The Act"].

2. 15 U.S.C. §§ 78a-78kk (1988).

3. Section 5 of the Securities Act of 1933 provides:

(a) unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section [10]; or

(2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section [10].

(c) it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication and interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section [8].

15 U.S.C. § 77e (1988).

4. Section 12 provides that:

Any person who—

(1) offers or sells a security in violation of section [5 of the Act], or

(2) offers or sells a security . . . by the use any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not

curities purchase or for the collection of damages if the disenfranchised investor has sold the security.

One question which has led to a significant amount of litigation under section 12 is the issue of when someone who participates in the distribution of false or misleading information regarding a security should be held liable as a "seller" of securities under the Act. Section 12(1) provides that any person who "offers or sells a security" in direct violation of the registration requirements set forth in section 5 may be liable in an action brought by the purchaser.⁵ Section 12(2) similarly imposes liability on any offeror or seller of a security who communicates any form of information containing a material untrue statement or fails to include any material fact.⁶

The reason that investors have persistently sought to establish liability against attorneys and accountants under section 12, is that the provision is viewed as imposing strict liability on anyone violating it. There is no question that an attorney who prepares false or misleading documents in connection with the sale of a new securities offering will be subject to an action under the 1933 Act. However, if such conduct is not viewed as constituting participation as a "seller" under section 12, then the attorney is afforded the statutory defenses provided under section 11. These defenses include but are not limited to: due diligence, reliance on expert opinion, or lack of causation, and are available to everyone except the issuer. Quite obviously, the investor has everything to gain by pursuing strict liability under section 12 while denying the attorney any defenses comparable to what would be available in a traditional common law negligence lawsuit. The question of whether "seller" status should be extended to collateral participants in the registration and sales processes, such as attorneys and accountants, and thereby subject them to the strict liability standards of section 12, is the subject of this Article.

As third party investors in failed business ventures sought to expand the liability net during the last decade, they quite naturally looked to the culpability of attorneys and accountants who had participated in preparation of legal and financial documents supporting the failed enterprise. So pervasive was the zeal to extend the liability of failed business ventures that the large accounting firms took a formal

sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest . . . upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 771 (1988).

5. *Id.* § 772.

6. *Id.* § 771.

position that a liability crisis was on the verge of decimating the profession unless something was done to curb these lawsuits.⁷ Accountants, in particular, have watched as their liability has been expanded through a series of judicial rulings. Interestingly, in more recent years the courts have evidenced a willingness to revisit the liability issue, and in fact, give every appearance that a period of judicial retrenchment is beginning.

The issue of aiding and abetting liability under section 10(b) of the Securities and Exchange Act of 1934 was recently considered by the United States Supreme Court in the 1994 case, *Central Bank of Denver v. First Interstate Bank*.⁸ In that case the Court held that under this section, a civil liability action against accountants for aiding and abetting securities fraud could not be established.⁹ Similarly, a year earlier the Court carved a more limited interpretation of RICO actions against accountants in a case involving auditor liability. In *Reves v. Ernst & Young*,¹⁰ the plaintiffs had filed suit against the auditors alleging that they had been involved in a fraudulent sale of securities scheme.¹¹ The Court chose to narrowly interpret the manner in which RICO can be applied to accountants performing the auditing function, and the case has generally been regarded by professionals as an appropriate step in the direction of limiting accountants' liability.¹²

As for state law actions, the Supreme Court of California rejected its longstanding reliance on the "foreseeable users" rule in third party negligence actions against professionals in *Bily v. Arthur Young & Company*.¹³ The California court adopted the position set forth in the *Restatement (Second) of Torts* which provides that third parties should be afforded protection in such cases only where it can be demonstrated that they fall within a limited class of individuals who are known to be actual or potential users of the information.¹⁴

The interesting aspect of this shift in judicial temperament regarding the liability of accountants and other professionals involved in facilitating business transactions is that during the same time period these third parties attempted to establish liability under section 12(2). However, while all these other aforementioned legal avenues being pursued by disenfranchised investors were producing one court vic-

7. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, A SPECIAL REPORT BY THE PUBLIC OVERSIGHT BOARD OF THE SEC PRACTICE SECTION, AICPA (1993); ARTHUR ANDERSEN & CO. ET AL., THE LIABILITY CRISIS IN THE UNITED STATES: IMPACT ON THE ACCOUNTING PROFESSION (Aug. 6, 1992).

8. 114 S. Ct. 1439 (1994).

9. *Id.* at 1455.

10. 113 S. Ct. 1163 (1993).

11. *Id.* at 1168.

12. *Id.* at 1172.

13. 834 P.2d 745, 755-57 (Cal. 1992).

14. *Id.* at 757-59.

tory after another, the judiciary has remained consistent in rejecting the theory that collateral participants, such as accountants and lawyers, who advise and represent the failed business venture, ought to be held liable under section 12(2) as "sellers" of securities. The federal courts have been steadfast in this position since the Supreme Court's *Pinter v. Dahl*¹⁵ decision in 1988.

Even though both sections 12(1) and 12(2) contain comparable language referring to offering or selling a security, significant controversy existed as to whether an individual had to be both an offeror and the seller of the securities in order to be liable under the section. A straightforward interpretation of both subsections would seem to indicate that anyone who offers to sell a security would only be liable if she also acted as the seller of the security. This interpretation focuses on the passage of title rather than the activities involved in promoting, soliciting, and distributing information regarding the security issue.

Another interpretation as to who should be held liable under these two subsections as a seller of securities focuses on the broader concept of solicitation and emphasizes the remedial nature of the statute relative to congressional intent that those who participate in the solicitation of possible purchasers be held accountable. Accordingly, several courts of appeal adopted the "substantial factor" test as a basis for liability under section 12.¹⁶ This test went beyond the strict language of the statute by imposing liability on collateral participants who played a material role in the selling process but who did not actually pass title to the securities.¹⁷ The substantial factor test was variously criticized for its deviation from a strict reading of the statute.¹⁸ The issue focused on just how broadly section 12 should be interpreted in order to achieve the remedial purpose of the statute.

The seller status controversy was clarified in *Pinter v. Dahl* where the Supreme Court rejected the substantial factor standard¹⁹ and held that statutory seller status should also include "an individual who engages in solicitation, an activity not inherently confined to the actual owner, within the scope of section 12."²⁰ Although *Pinter* was a section 12(1) case and did not involve professionals such as accountants

15. 486 U.S. 622 (1988).

16. *Wilson v. Ruffa & Hanover, P.C.*, 844 F.2d 81, 84 (2d Cir. 1988); *Foster v. Jesup & Lamont Sec. Co.*, 759 F.2d 838, 844-46 (11th Cir. 1985); *Anderson v. Aurotek*, 774 F.2d 927, 930 (9th Cir. 1985); *Swenson v. Engelstad*, 626 F.2d 421 (5th Cir. 1980); *Collins v. Signetics Corp.*, 605 F.2d 110, 114-15 (3d Cir. 1979); *Lawler v. Gilliam*, 569 F.2d 1283, 1287-88 (4th Cir. 1978).

17. See *supra* notes 1-6 and accompanying text.

18. Patricia A. O'Hara, *Erosion of the Privity Requirement in Section 12(2) of the Securities Act of 1933: the Expanded Meaning of Seller*, 31 UCLA L. REV. 921 (1984).

19. *Pinter v. Dahl*, 486 U.S. 622, 653-54 (1988).

20. *Id.* at 643.

and lawyers, the significant question that is now presented concerns the extent to which this case precedent should be extended to cover the activities of those professionals who are materially involved in the structuring and selling of a security issue. Specifically, the role of accountants and attorneys is particularly critical in the registration and distribution process, and courts must now address when the conduct of these individuals transcends the solicitation caveat contained within the *Pinter* case.²¹ At present, the Second and Ninth Circuit Courts of Appeal have issued rulings in cases involving professionals relative to their liability as securities sellers under *Pinter*.²²

This Article deals with the cases that have raised this issue and the reasons that the federal courts have uniformly and repeatedly rejected this cause of action. First, a review is provided of the criteria set forth by the Supreme Court in *Pinter v. Dahl* to be used in determining whether or not someone qualifies as a seller of securities.²³ Secondly, the cases decided pursuant to *Pinter* will be analyzed in an effort to discern any commonalities with regard to the liability of professionals in the security issuance process.²⁴ In this effort the role of the accountant will be considered in the security placement process and appropriate professional standards will be reviewed in determining the present liability status of these professionals.²⁵

II. ESTABLISHING SELLER STATUS UNDER SECTION 12(2)

A. *Pinter v. Dahl*—Background

Maurice Dahl, a California real estate broker and investor, was interested in entering the oil business and made several unsuccessful attempts to do so. He subsequently was introduced to Billy J. Pinter who was an oil and gas driller in Texas and Oklahoma operating under the firm name Black Gold Oil Company.²⁶ Pinter represented himself to be a licensed oil and gas securities broker-dealer in Texas with 20 years experience.²⁷ He also informed Dahl of five oil wells

21. The Supreme Court in *Pinter* did not address this specific issue. It merely noted that the substantial factor test was so broad so as to bring all types of collateral participants within its purview. *Id.* at 651.

22. *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531 (9th Cir. 1989); *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989).

23. See *infra* notes 26-44 and accompanying text.

24. See *infra* notes 204-211 and accompanying text.

25. See *infra* notes 212-229 and accompanying text.

26. Petitioner's Appendix at 31, *Pinter v. Dahl*, 486 U.S. 622 (1988)(No. 86-805). Respondent Dahl had invested in a number of other oil deals in 1980 and 1981 through several closely held corporations. Dahl had also hired an expert to find appropriate oil and gas properties for leasing. It was this expert who introduced Dahl to Billy J. Pinter.

27. Opposition Brief at 6, *Pinter* (No. 86-805).

that were available for immediate leasing.²⁸ After inspecting the properties and reviewing pertinent drilling records provided by Pinter, Dahl concluded that the investment was sound and loaned \$20,000 to Pinter to reserve the leases until other investors could be located.²⁹

Based on Dahl's advice eleven persons decided to invest about \$7,500 each in the project.³⁰ Each individual was a personal friend, family member or business associate of Dahl who relied exclusively on his opinions in reaching a decision to invest in the project.³¹ With one exception the investors resided in the State of California and did not personally visit or inspect the leased properties.³² Not only did they rely on the representations made by Dahl in reaching the decision to invest, they also received his assistance in completing letter contracts.³³ For his role in securing the additional investors Dahl received no compensation or commissions of any kind.³⁴ The lease contracts contained a clause noting that registration with the Securities and Exchange Commission had not been completed.³⁵

When the leases subsequently proved to be worthless, Dahl and the other co-investors sought to establish that a fraud had been committed by Pinter and that the only appropriate remedy would be rescission of the contracts based on the section 12(1) prohibition against selling unregistered securities.³⁶ They sought damages under section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5.³⁷ In a counterclaim Pinter argued that Dahl had misrepresented the investment experience of himself and the other investors and had not provided the buyers with all the material information required to evaluate the investment project.³⁸ Pinter also alleged that Dahl had agreed to manage certain financial aspects of the venture but had also

28. Petitioner's Appendix at 32, *Pinter* (No. 86-805).

29. *Pinter v. Dahl*, 486 U.S. 622, 625-26 (1988). Following the inspection of the drilling records Dahl concluded that "there was no way to lose." *Id.*

30. *Id.* at 626. Dahl personally invested about \$310,000 in the leases. The other investors were either close friends or family members of Dahl and included: his brother, his fiancée, his accountant, the bank officer handling his construction loans, a construction business partner, his construction financier, his construction-business insurance agent and other business persons. Petitioner's Appendix at 33, *Pinter* (No. 86-805).

31. *Pinter v. Dahl*, 486 U.S. 622, 625 (1988).

32. Petitioner's Appendix at 32, *Pinter* (No. 86-805).

33. *Pinter v. Dahl*, 486 U.S. 622, 625 (1988).

34. Petitioner's Appendix at 34, *Pinter* (No. 86-805).

35. The contracts noted that the entries were being sold "without the benefit of registration under the Securities Act of 1933, as amended, and on reliance of rule 146 thereunder." Opposition Brief at 39, *Pinter*, (No. 86-805).

36. *Pinter v. Dahl*, 486 U.S. 622, 627 (1988).

37. *Id.* at n.4. The Supreme Court did not consider the section 10(b) claims asserted by the respondents. *Id.*

38. *Id.* at 628.

agreed not to get involved in operational matters.³⁹ From Pinter's point of view this involvement was the primary reason why the business venture did not qualify for a private placement exemption from registration requirements established in the 1933 Act.⁴⁰ Pinter contended that it would be inequitable to permit Dahl to seek legal redress with the other investors. Pinter claimed that he and Dahl were equally at fault, and therefore, *in pari delicto*.⁴¹

The district court ruled that Dahl and the other investors could rescind or cancel the contracts under section 12(1) since the investments should have been registered as securities.⁴² The Fifth Circuit affirmed this decision by ruling that Dahl was not a "seller" within the context of section 12 because he had not received any pecuniary benefit from his promotional activities.⁴³ A subsequent request for rehearing was denied, and the Supreme Court agreed to review the case.⁴⁴

B. Analysis of *Pinter*

The Supreme Court reached the same conclusion as the Fifth Circuit Court of Appeals using a slightly different rationale. Initially, the Court recognized that the definition of a statutory seller could not be

39. *Id.*

40. See 15 U.S.C. § 77d(2) (1988)(creating the "private offering exceptions" from registration requirements imposed by the Act). Regulation D, 17 C.F.R. §§ 230.501 to .508 (1994), currently governs non-public offerings. An offering will be exempt if it meets the following stipulations:

[T]he offering must (1) not be made by any means or form of general solicitation or advertising; (2) be made only to those persons whom the issuer has reasonable grounds to believe are of knowledge and experience which would enable them to evaluate the merits of the issue or who are financially able to bear the risk; (3) be made only to those persons who have access to the same kind of information as would be contained in a registration statement. Under this rule, the issuer must have reasonable grounds to believe, and must believe, that there are no more than thirty-five purchasers from the issuer.

Mary S. Krech Trust v. Lakes Apartments, 642 F.2d 98, 101 (5th Cir. 1981)(citing 17 C.F.R. § 230.146 (1980)).

41. *Pinter v. Dahl*, 486 U.S. 622, 628 (1988). For a complete discussion of the *in pari delicto* issue, see Robert A. Prentice, *Section 12 of the Securities Act of 1933: The Case of the Overly Eager Investor*, 23 NEW ENGLAND L. REV. 697 (1988-89).

42. *Pinter v. Dahl*, 486 U.S. 622, 628 (1988).

43. *Pinter v. Dahl*, 787 F.2d 985, 991 (5th Cir. 1986). The Fifth Circuit acknowledged that Dahl was a substantial factor in consummating the securities purchase; however, it held that anyone who acts as a promoter must be "motivated by a desire to confer a direct or indirect benefit on someone other than the person he has advised to purchase." *Id.* This ruling was supported by the rationale that liability should not be imposed without fault or knowledge on "friends and family members who give one another gratuitous advice on investment matters." This would be an unreasonable interference with established patterns of social discourse. *Id.*

44. The rehearing was denied by an 8-6 vote. *Dahl v. Pinter*, 794 F.2d 1016 (5th Cir. 1986).

restricted simply to people who passed title to securities.⁴⁵ Looking to section 2(3) of the Securities Act, the Court noted that the term "sell" includes "every contract of sale or disposition of a security or interest in a security, for value,"⁴⁶ and that the term "offer" necessarily includes "every attempt or offer to dispose of, or solicitation of an offer to buy."⁴⁷ Relying on these definitions the Court concluded that a statutory seller was not necessarily restricted to the actual owner of the securities but also must include those who engage in solicitation of offers to buy.⁴⁸

This conclusion was supported by reasoning that the solicitation of a buyer is an extremely critical stage of the selling process and is directly aimed at producing a sale.⁴⁹ The inclusion of solicitors within the statutory definition of seller was conditioned on the requirement that the individual's "motivation is solely to benefit the buyer."⁵⁰ In accordance with the strict language of section 12(1), statutory liability should only encompass those individuals who solicit a purchase "motivated at least in part by a desire to serve his own financial interest or those of the securities owner."⁵¹ By ruling in this fashion the *Pinter* Court rejected the long-standing substantial factor standard that had been used by the Fifth Circuit. This standard was considered to be too heavily focused on an individual's involvement in the securities transaction and surrounding circumstances rather than looking at the relationship between purchaser and seller. In effect, the Supreme Court was rejecting any judicial inquiry into a seller's motivation as a proper basis for determining statutory status as a seller of securities.⁵² Although appropriate in tort law analysis, the elements of reliance and causation were held to be inappropriate in analyzing a statutory cause of action imposing a strict liability requirement.⁵³ The Court was also concerned that the substantial factor test would extend liability to collateral participants who were only remotely related to the

45. *Pinter v. Dahl*, 486 U.S. 622, 643 (1988).

46. *Id.*

47. 15 U.S.C. § 77b(3) (1988).

48. *Pinter v. Dahl*, 486 U.S. 622, 644-45 (1988).

49. *Id.* at 646-47.

50. *Id.* at 647.

51. *Id.*

52. *Id.* at 651. The Court stated:

The deficiency of the substantial factor test is that it divorces the analysis of seller status from any reference to the applicable statutory language and from any examination of section 12 in the context of the total statutory scheme. Those courts that have adopted the approach have not attempted to ground their analysis in the statutory language. . . . Instead, they substitute the concept of substantial participation in the sales transaction, or proximate causation of the plaintiff's purchase, for the words 'offers or sells' in section 12.

Id.

53. *Id.* at 652.

sales transaction.⁵⁴ This could necessarily include "securities professionals, such as accountants and lawyers, whose involvement is only in the performance of their professional services."⁵⁵ The Court then remanded the case to the Fifth Circuit for determination as to whether Dahl had encouraged the other investors in order to further his own personal financial interest or that of Mr. Pinter.⁵⁶

Pinter is a critical case with regard to the seller status controversy in that it establishes a two step process for determining seller liability. First, anyone who passes title of a security to a buyer who gives value in return will be classified as a seller under section 12(1).⁵⁷ However, where the transferor is not the title holder, the second part of the analysis requires an inquiry as to whether the individual solicited the purchase of the security.⁵⁸ Liability under this part of the test is imposed only where the solicitation is successful and is motivated by the desire to achieve a personal pecuniary gain or interest or to serve that same interest of the security owner. Obviously, it is this solicitation analysis that is critical to determining whether or not accountants and/or attorneys can be held liable as sellers of securities under section 12(1). It should also be noted that a person who did not have title to a security could assist the selling process but not be held liable as long as she did not intend to benefit herself financially or assist the title owner in achieving a similar financial gain.

This case also makes clear that the substantial factor test utilized in the Fifth Circuit will no longer be the appropriate test for establishing seller status liability.⁵⁹ In reality the substantial factor test was much broader than the *Pinter* standard in that almost anyone involved with any aspect of a security transaction could be found potentially liable as a seller.⁶⁰ Case law demonstrates that attorneys,⁶¹ investment bankers⁶² and accountants⁶³ who provide material assistance in drafting supporting documentation for security issuances were the primary targets under the substantial factor test.

Another contribution made by the *Pinter* case is the Court's effort to define the term "purchaser" relative to section 12(1).⁶⁴ Section 12

54. *Id.* at 651.

55. *Id.*

56. *Id.* at 655.

57. *Id.* at 642-43.

58. *Id.* at 646-47.

59. *Id.* at 650-51. The Court ruled that the substantial factor test "divorces the analysis of seller status from any reference to the applicable statutory language and from any examination of § 12 in the context of the total statutory scheme." *Id.* at 651.

60. *Id.* at 653-54.

61. *Koehler v. Pulvers*, 614 F. Supp. 829 (S.D. Cal. 1985).

62. *Adalman v. Baker, Watts & Co.*, 807 F.2d 359 (4th Cir. 1986).

63. *Gold v. LTV Corp.*, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,654 (N.D. Tex. 1984).

64. *Pinter v. Dahl*, 486 U.S. 622, 645 (1988).

liability is predicated on establishing plaintiff's standing as a purchaser of a security, and anyone failing to meet this requirement is precluded from seeking the statute's strict liability remedies.⁶⁵ The reason that this definition is critical is because the statute itself simply defines the terms "sell" and "sale."⁶⁶ The Court stated that liability under section 12 could only occur where a sale had been established; and therefore, the word "purchase" had to be compared with the statutory term "sale."⁶⁷ Since the terms "sell" and "offer" are the primary focus of the 1933 Act, the Court very neatly incorporated the act of solicitation within the same process.⁶⁸ In equating the term sale with a purchase, the Court established that a security purchase could occur where title was passed to a purchaser or where the purchaser bought the security as a result of overt solicitation.⁶⁹ It is evident that the Court was stating that where a sale is established there is impliedly a purchase as well. Furthermore, the purchase analysis is the same as that put forward to determine whether a collateral participant should also be deemed to be a statutory seller under the 1933 Act.

An important limiting feature of the *Pinter* case is the Court's refusal to extend its holding beyond section 12(1).⁷⁰ Since sections 12(1) and 12(2) include similar purchaser and seller requirements, the Court could have provided a consistent standard to be used in all section 12 litigation. This is material to attorneys and accountants since their liability under the 1933 Act could be predicated on conduct challenged under either sections 12(1) or 12(2). Furthermore, a key component part of the *Pinter* decision was the emphasis on the word "solicit" and the process of "solicitation."⁷¹ It is the solicitation process which presents the greatest possibility for attorney and accountant liability with regard to the selling and distribution of securities. Even though *Pinter* was not specific as to what type of conduct would constitute solicitation on the part of attorneys and accountants, several subsequent cases have been decided by the Second, Seventh and Ninth Circuit Courts of Appeal which have addressed this issue directly⁷². These cases speak more forthrightly relative to the type of conduct for which attorneys and accountants will be held liable pursuant to the *Pinter* decision.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* at 646.

70. *Id.* at 642 n.20.

71. *Id.* at 646-47.

72. See *supra* note 22 and *infra* notes 138, 163 and 182 for case citations.

III. EXTENDING *PINTER* TO ATTORNEYS AND ACCOUNTANTS

A. Second Circuit—*Wilson v. Ruffa & Hanover, P.C.*

In March 1981, plaintiff Kenneth Wilson was contacted by Fred Rodolfy, chairman and principal shareholder of Saintine Exploration and Drilling Corporation ("Saintine").⁷³ Rodolfy suggested that Wilson invest in the stock of Saintine, recommending the company as an excellent investment.⁷⁴ In early April 1981, Saintine's counsel, Ruffa & Hanover, sent Wilson a private placement memorandum and subscription materials for a one million share private offering in Saintine stock.⁷⁵ These materials were accompanied by a letter on Ruffa & Hanover firm stationery stating that the materials had been provided pursuant to the request of Saintine officials.⁷⁶

The subscription materials explained that the company had been formed to explore and develop oil and gas interests in Central America, specifically in Honduras.⁷⁷ The memorandum also explicitly stated that Saintine had signed contractual agreements providing it exclusive rights to explore and develop certain oil and gas interests in Honduras.⁷⁸ In effect, this statement was a misrepresentation since such an agreement was not entered into until May 27, 1981, and ultimately finalized at a later date.⁷⁹ Wilson ultimately invested \$36,000 in 90,000 shares of Saintine stock on May 7, 1981.⁸⁰ The company never pursued the Honduran drilling program as promised, and subsequently, Rodolfy informed Wilson that his investment would be returned.⁸¹ Only \$5,000 of the original investment was ever refunded to Wilson.⁸²

Wilson filed an action against the company and Ruffa & Hanover alleging that they were liable as sellers of securities under section 12(2) of the Securities Act.⁸³ The district court held in favor of Wilson since Ruffa & Hanover had prepared the statement and the agreement had not yet been completed. A panel of the Second Circuit Court of Appeals reversed the judgment against the law firm holding that a section 12 action against non-selling collateral participants, such as a

73. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989).

74. *Id.* at 1124-25.

75. *Id.* at 1125.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Wilson v. Ruffa & Hanover, P.C.*, 844 F.2d 81, 82 (2d Cir. 1988).

law firm, required proof of causation.⁸⁴ Even though the agreement to conduct the Honduran drilling operation had been reached subsequent to the issuance of the private placement memorandum, the court held that Wilson had not established that his losses had been caused as a result of this misrepresentation.⁸⁵ The Second Circuit later vacated this opinion and permitted the parties to rebrief and reargue the case in light of *Pinter v. Dahl*. The court ultimately affirmed its original holding based on the seller status grounds contained within the *Pinter* case.⁸⁶

In its final decision, the Second Circuit noted that *Pinter* expressly held that statutory sellers will be liable under section 12(1) regardless of whether loss causation is established.⁸⁷ It also stated that the *Pinter* court limited its holding to section 12(1); however, the Second Circuit noted case precedent in which it had concluded that sections 12(1) and 12(2) are identical in meaning.⁸⁸ By virtue of this conclusion, the statutory seller status test established in *Pinter* could be appropriately applied to the actions of Ruffa & Hanover relative to its role in seeking Wilson's investment in Saintine.⁸⁹

The Second Circuit went on to state that the *Pinter* case had the effect of expanding in some cases and contracting in others the category of individuals who might potentially be held liable under section 12(2).⁹⁰ Circuit case law prior to *Pinter* had established a distinction between individuals in privity with a buyer versus collateral participants in the same securities transaction. Where privity existed, section 12(2) was to be applied literally and this included strict liability for any negligent misrepresentation.⁹¹ Collateral participants, on the other hand, only faced liability where scienter and loss causation could be proven.⁹²

84. *Id.* at 86.

85. *Id.* at 85.

86. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1127 (2d Cir. 1989).

87. *Id.* at 1126.

88. *Id.* (citing *Schillner v. H. Vaughan Clarke & Co.*, 134 F.2d 875 (2d Cir. 1943)). The court also held that the *Pinter* standard applied to section 12(2). *Id.* (citing *Capri v. Murphy*, 856 F.2d 473 (2d Cir. 1988)).

89. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989).

90. *Id.*

91. *Id.* See also *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1298 (2d Cir. 1973).

92. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989). The court cited its decision in *Mayer v. Oil Field Systems Corp.*, 803 F.2d 749 (2d Cir. 1986), where a partnership's general partners exchanged all shares of the partnership for stock in another firm as a method of completing their payout obligation to the limited partners. The stock that was received ultimately traded at a deficient price and the limited partners filed a lawsuit. The Second Circuit held that the general partners were not collateral participants in the transaction because they were not in contractual privity with the limited part-

For those individuals not in privity with the plaintiff but who would have been categorized as collateral participants under previous circuit caselaw, statutory seller status would be accorded under *Pinter* where it can be shown that they solicited the purchase for a pecuniary gain.⁹³ Such liability under section 12 for these collateral participants will be based strictly on the solicitation question regardless of any proof regarding scienter or loss causation.⁹⁴ In this respect the potential liability of these collateral participants is substantially expanded by the *Pinter* decision.⁹⁵ Likewise, individuals who are not in privity with the plaintiff but who could have been classified as collateral participants under prior caselaw will not be accorded statutory seller status unless it can be proven that they solicited the security sale.⁹⁶ These individuals will not be subject to liability under section 12, and based on previous Second Circuit case precedent, their potential liability as a group has been significantly restricted by *Pinter*.⁹⁷

The Second Circuit then went on to classify Ruffa & Hanover as falling within the category of collateral participants whose potential seller liability would be contracted rather than expanded by the *Pinter* case.⁹⁸ The firm's conduct in the questioned securities transaction was characterized as consisting "solely of the ministerial act of mailing a copy of the private placement memorandum to Wilson at Rodolfy's request."⁹⁹ Interpreting the *Pinter* Court, the Second Circuit noted that the primary concern had to do with persons such as individual brokers who were likely to act on behalf of the seller and to do so for a personal pecuniary profit.¹⁰⁰ It would be a severe misinterpretation of the *Pinter* standard to view the actions of Ruffa & Hanover as constituting the kind of solicitation necessary to delineate seller status under the 1933 statute.¹⁰¹ The provisions of section 12 are severe and should not be extended to include professionals such as lawyers who have merely performed normal professional duties. The

ners. Furthermore, liability under section 12(2) could at that time only be permitted where scienter could be proven. The *Wilson* court noted that had the *Mayer* case been decided subsequent to *Pinter v. Dahl*, the material question would not have been whether or not the general partners had scienter but would have focused on whether or not the financial gain which they had received upon creating the exchange "was the legal equivalent of solicitation of a sale." *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989).

93. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989).

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.* at 1126-27.

101. *Id.* at 1127.

Wilson court did admit that where an attorney earned actual commissions from the seller for convincing clients to make an investment in a security offering, he would be liable as a statutory seller.¹⁰²

The final issue dealt with by the Second Circuit in the *Wilson* case concerned Ruffa & Hanover's potential liability as aiders and abettors.¹⁰³ Wilson attempted to argue that the *Pinter* decision did not rule out the possibility of aider and abettor liability under section 12.¹⁰⁴ The court of appeals refused to adopt this approach holding instead that there was no difference "under Section 12 between liability based on aiding and abetting and liability based on collateral participation."¹⁰⁵ In this respect, the Second Circuit adopted the position put forward by the SEC as an *amicus* party in the *Pinter* case.¹⁰⁶ Based on this analysis the Second Circuit again concluded that Ruffa & Hanover could not be held liable as statutory sellers of securities under section 12(2), but that such a determination in no way diminished their potential liability under section 10(b) and Rule 10b-5.¹⁰⁷

B. Ninth Circuit—*Moore v. Kayport Package Express*¹⁰⁸

The principals involved in this business venture organized tax sheltered limited partnerships. The limited partnership interests were not registered with the Securities and Exchange Commission despite the fact that they were securities as defined by federal statute.¹⁰⁹ The same interests also did not qualify for exemption from the

102. *Id.*

103. *Id.* The court agreed with the position of the Securities and Exchange Commission as put forward in its *amicus* brief:

Section 12(2) does not permit an analogy to tort or criminal law. The provision merely imposes civil liability on a statutory seller in favor of an aggrieved investor; it neither defines violations nor makes certain acts unlawful. As a result, a criminal law analogy is not available (citation omitted). Likewise, the Section based on rescission is not derived from tort law principles, making the tort theory employed in the context of the Section 10(b) inapplicable.

Id. (quoting Brief for the Securities and Exchange Commission at 19).

104. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1127 (2d Cir. 1989). *Wilson* argued that footnote 24 of the *Pinter* decision established that the Supreme Court did not rule out the possibility of aider and abettor liability under Section 12, citing *Mayer v. Oil Field Systems Corp.*, 803 F.2d 749, 756 (2d Cir. 1986), and *In re Caesar's Palace Securities Litigation*, 360 F. Supp. 366 (S.D.N.Y. 1973).

105. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1127 (2d Cir. 1989). See also *In re Caesar's Palace Securities Litigation*, 360 F. Supp. 366 (S.D.N.Y. 1973).

106. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1127 (2d Cir. 1989).

107. *Id.*

108. 885 F.2d 531 (9th Cir. 1989).

109. *Id.* at 533.

registration process.¹¹⁰ During 1981 and 1982, sales of these limited partnership interests aggregated in excess of \$3.8 million.¹¹¹

In addition to failing to register the limited partnership interests, the principals engaged in practices deemed to be fraudulent and made numerous misrepresentations to investors with regard to the financial viability of each partnership interest.¹¹² After the investors lost a significant amount of their investment they filed an initial complaint in September 1983 alleging violations of section 12(2) of the Securities Act of 1933.¹¹³ They sued the principals involved in the venture as well as various accountants, lawyers, and stock brokers who had allegedly assisted in the sale of the investments.

The district court dismissed the claims against the defendant accountants and lawyers stating that they had not been a substantial factor in facilitating the securities transactions in question.¹¹⁴ As a result, they were not subject to liability under section 12(2). The Ninth Circuit affirmed this ruling but did so on the basis of an analysis of the *Pinter* decision which had been decided by the Supreme Court subsequent to the decision rendered by the lower district court.¹¹⁵

Initially, the court of appeals acknowledged that the "substantial factor test" had been the primary standard to be used in establishing seller status and had been appropriately applied by the district court.¹¹⁶ The court of appeals noted that under this test "persons who did not pass title in a sales transaction, and thus were not in privity with the purchaser, may nonetheless be liable as a 'seller' if their actions were both necessary to and a substantial factor in bringing about the sales transaction."¹¹⁷ The Ninth Circuit went on to recognize that due to the opinion in the *Pinter* case, seller status liability had been extended beyond those who passed title to a security to include those

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.* The plaintiffs also alleged several pendent state causes of action. *Id.*

114. *Id.* at 534.

115. *Id.* at 537. The Ninth Circuit stated:

Under the *Pinter* analysis, (attorneys and accountants) are only subject to section 12(2) liability if they solicited the purchases and were motivated, at least in part, by financial gain. . . . Here, the investors did not allege that the lawyers or accountants played any role at all in soliciting the purchases. Rather, the investors alleged that these defendants performed professional services in their respective capacities as accountants and lawyers.

Id. (citation omitted).

116. *Id.* at 535.

117. *Id.*

who solicited a purchase.¹¹⁸ The court then reviewed the primary findings of the *Pinter* decision and applied them to the facts in the *Moore* case to determine whether the defendant accountants and attorneys had in fact solicited the purchase of securities. This analysis was based on whether they were motivated to serve a personal financial interest or that of the securities owner.¹¹⁹

The court of appeals established that there is an important distinction between those who solicit purchases and those who simply assist in the solicitation effort.¹²⁰ It is clear that the *Pinter* Court rejected the substantial factor test because it fails to distinguish between actual solicitation and mere collateral participation in the offer to sale.¹²¹ The Ninth Circuit focused on the *Pinter* Court's statement that professionals such as attorneys and accountants should not be held liable under section 12(1) simply for providing professional services.¹²² Such an application of section 12(1) strict liability, the court argued, might expose these professionals to excessive liability.¹²³ Moore also argued that the *Pinter* seller status standard only applies to section 12(1) and that the Supreme Court expressly rejected the opportunity to apply it to section 12(2).¹²⁴ As a result, the Ninth Circuit should apply the substantial factor standard in 12(2) litigation.¹²⁵ This argument was based on the claim that section 12(1) is a strict liability provision whereas section 12(2) permits the defense of reasonable care.¹²⁶ Secondly, plaintiff investor argued that section 12(2) is based in tort law while section 12(1) is based in contract law; therefore, "the related concepts of proximate cause and substantial factor are thus appropriate in actions under the tort-based section 12(2), even though more involvement is required by *Pinter* in actions under section 12(1)."¹²⁷

The court of appeals rejected this contention stating that the language contained in section 12(2) is identical to that in section 12(1).¹²⁸ Reference to the definitions section of the statute indicates that the word "offers" is meant to apply to all provisions of section 12.¹²⁹ In addition, the purpose of both subsections is to promote full and fair

118. *Id.* The Ninth Circuit acknowledged that the *Pinter* Court did not define the term "solicit" but explained that a solicitation could not take place where a person's motivation was to solely benefit the buyer. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.* at 535-36.

123. *Id.*

124. *Id.* at 536.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.* The court stated:

disclosure of information needed by potential securities investors.¹³⁰ The court concluded its analysis by stating that the *Pinter* seller status standard was the appropriate standard for determining liability under both sections 12(2) and 12(1) of the Securities Act of 1933.¹³¹

The court then turned to an analysis of the facts in the *Moore* case relative to its conclusion that the *Pinter* standard must necessarily displace the substantial factor test. Regarding the involvement of the defendant accountants, the plaintiffs argued that they had drafted financial documents which the brokers had used in selling the unregistered securities.¹³² The attorneys allegedly drafted false or misleading prospectuses, directed the issuance of securities, participated in meetings where the promotional literature was drafted, provided advice and counsel to the security owners, and drafted tax opinions and permitted these opinions to be included in the promotional materials.¹³³ Additionally, one attorney supposedly allowed his name to be used on the promotional literature as general counsel to the firm.¹³⁴ These allegations were dismissed as failing to state a claim under section 12(2) since these professionals would only be subject to liability if they had "solicited" the securities purchases motivated, to some degree, by a personal financial gain.¹³⁵ The court specifically stated that the investor plaintiffs had not alleged that the defendant lawyers and accountants had played any role whatsoever in the soliciting of the stock purchases.¹³⁶ The investors simply alleged that the defendants had performed professional services to facilitate the transaction.¹³⁷ This type of conduct is insufficient to confer seller status under the *Pinter* standard.

C. The *Wilson* and *Moore* Case Line

In *Royal American Managers, Inc. v. IRC Holding Corp.*,¹³⁸ Royal American Managers, Inc. ("RAM") made a decision in 1984 to

Moreover, the section 2(3) definition of "offers" applies with equal force to sections 12(1) and 12(2); and the word "offers" appears as part of parallel introductory language common to both sections 12(1) and 12(2). It seems plain from the statute that the word "offers" means the same thing in both sections.

Id.

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* at 536-37.

134. *Id.* at 537.

135. *Id.*

136. *Id.*

137. *Id.* The court of appeals also affirmed the lower court's decision to dismiss the pendent state claims against the accountant and lawyer defendants. *Id.*

138. 885 F.2d 1011 (2d Cir. 1989).

purchase an insurance or reinsurance company.¹³⁹ James Wining, Vice-Chairman of RAM, entered into discussions with Joseph Ambriano, one of the officers and directors of IRC Holding Corporation. IRC wholly owned the Interamerica Reinsurance Corporation ("Interamerica").¹⁴⁰ Willie Schonacher, Chairman and CEO of RAM, soon became involved with the discussions, and Wining eventually proposed that RAM purchase 50% of Interamerica's stock.¹⁴¹ IRC rejected this offer since it not only would mean that IRC would lose control of Interamerica, but also that the New York State Insurance Department ("NYSID") would have to preapprove such a deal given the possibility that the transaction might be considered a "change of control" of Interamerica under New York law.¹⁴² Since the prior approval process could take many months, IRC preferred to avoid it.

The parties finally decided to contact Gerald Dolman, IRC's attorney, who had formerly been an NYSID employee and had been instrumental in drafting the state law requiring preapproval.¹⁴³ Dolman told Wining that in his opinion, a sale of 49% of the stock would not require preapproval.¹⁴⁴ On October 30, 1984, the parties and Dolman met, and Dolman once again explained his experience and opinion in the matter. Representations were also made concerning the appointment of RAM nominees to assist in the directorship and management of Interamerica.¹⁴⁵ Following this meeting, the parties' attorneys prepared contracts and related documents for the sale of 49% of Interamerica's stock. At a final meeting in December, Ambriano stated that the terms of the documents did not agree with the terms discussed by the parties. The attorneys were eventually excluded from the meeting, and the representations earlier made by IRC were allegedly repeated to Wining and Schonacher.¹⁴⁶

RAM finally purchased a 49% interest in Interamerica for nearly four million dollars.¹⁴⁷ However, the NYSID learned of the sale and told Dolman that prior approval of the sale was necessary.¹⁴⁸ NYSID ignored Dolman's arguments to the contrary and began requesting information from RAM. RAM was initially cooperative, but by the autumn of 1985, it had stopped providing information and asked that the process be put on hold.¹⁴⁹ As of the time of the court of appeals opin-

139. *Id.* at 1013.

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.* at 1014.

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

ion, the dispute had not been resolved even though RAM continued to control 49% of Interamerica's stock.¹⁵⁰

RAM filed suit against IRC, Ambriano, and Dolman, seeking rescission and damages.¹⁵¹ It alleged that all three defendants violated section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934¹⁵² and section 12(2) of the Securities Act of 1933, and were further guilty of common law fraud.¹⁵³ These allegations were based on the argument that the purchase resulted from the defendants' misrepresentations concerning the preapproval process.¹⁵⁴ IRC and Ambriano cross-claimed against Dolman for legal malpractice.¹⁵⁵ A jury trial was held, but the district court dismissed most of RAM's claims, including all claims against Dolman. However, the section 10(b) and common law fraud claims against Ambriano and IRC went to the jury. RAM moved to amend its complaint to avoid the dismissal of its claims against Dolman, but these motions were denied.¹⁵⁶ The jury found for the defendants, and the district court then dismissed the rest of the claims.¹⁵⁷ RAM filed an appeal, contending, *inter alia*, that the district court erred in dismissing its section 12(2) claim against Dolman.¹⁵⁸ The court of appeals began its discussion of this argument by noting that, unlike section 10(b) of the 1934 Act, section 12(2) of the 1933 Act applies only to the "seller of securities."¹⁵⁹ "Seller" was defined by *Pinter* as an "owner who passed title, or other interest in the security, to the buyer for value," or a "person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner."¹⁶⁰ The court went on to quote *Pinter's* exhortation against exposing experts, such as attorneys, to section 12(2) liability merely because they rendered professional services to a seller.¹⁶¹

The court of appeals ruled that Dolman clearly was not a seller. First, he was not an owner who passed title. Secondly, IRC, not Dolman, initiated the negotiations, and thus solicited the sale since Amb-

150. *Id.*

151. *Id.*

152. 15 U.S.C. § 78j(b) (1988).

153. *Royal American Managers, Inc. v. IRC Holding Corp.*, 885 F.2d 1011, 1014 (2d Cir. 1989).

154. *Id.* at 1013-15.

155. *Id.* at 1014.

156. *Id.*

157. *Id.*

158. *Id.* RAM further contended that the district court improperly did not allow it to amend its complaint to allege legal malpractice against Dolman. RAM did not challenge the jury's verdict but did challenge the court's determinations regarding its Section 12(2) claims against Ambriano and IRC.

159. *Id.* at 1016.

160. *Id.* at 1016-1017 (quoting *Pinter v. Dahl*, 486 U.S. 622, 642, 647 (1988)).

161. *Id.* at 1017.

riano had suggested how to structure the sale to avoid the preapproval process. Dolman did not even attend critical meetings and departed some meetings early. Furthermore, he did not "earn a commission from an actual seller for persuading [the buyer] to make a particular investment." Although Dolman was a director and executive committee member of Interamerica, it was apparent that Ambriano ran the company. Accordingly, the district court did not err in dismissing for lack of proof the section 12(2) claim brought against Dolman.¹⁶²

In *Sellin v. Rx Plus, Inc.*,¹⁶³ a case brought in the Southern District of New York, the defendant, Rx Plus, was a corporation¹⁶⁴ whose purpose was to establish a chain of drug stores.¹⁶⁵ In early 1987, Rx Plus issued a confidential private placement memorandum to the various plaintiffs.¹⁶⁶ The named plaintiff, Alison Sellin, invested \$60,000 in Rx Plus' stock.¹⁶⁷ The plaintiffs later alleged that the memorandum did not meet the disclosure requirements provided for in federal securities laws or SEC regulations.¹⁶⁸ In September 1987, Rx Plus admitted that this might be true, and offered investors the opportunity to rescind their purchases. Sellin and the other plaintiffs did so, but when no refund was forthcoming, they filed a federal lawsuit against Rx Plus' parent corporation, members of Rx Plus' corporate board, and the attorney, individually, who drafted the placement memorandum, as well as his law firm.¹⁶⁹ The suit, grounded on section 12 of the 1933 Act, alleged that the defendants had intentionally released a deficient placement memorandum, and further alleged that the law firm had been directly involved in marketing the improperly issued Rx Plus stock.¹⁷⁰

The attorney and his law firm moved for summary judgment on the claims against them.¹⁷¹ After an extensive discussion of the law pertaining to summary judgment, the district court stated that "[i]n this case, the central issue is whether a law firm which prepared a private placement memorandum used in allegedly fraudulent sales of securities can be held liable under Section 12 of the Securities Act of 1933."¹⁷² The district court began its discussion of this issue by analyzing *Pinter*. It stated that while the Supreme Court recognized the

162. *Id.*

163. 730 F. Supp. 1289 (S.D.N.Y. 1990).

164. Rx Plus was a subsidiary of Medi-Rx America, Inc., a Delaware corporation whose business involved selling prescribed medications and medical equipment by mail order.

165. *Sellin v. Rx Plus, Inc.*, 730 F. Supp. 1289, 1289 (S.D.N.Y. 1990).

166. *Id.* at 1290.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.* at 1291.

similarity of the language of sections 12(1) and 12(2), it had not decided whether the definition of "seller" for section 12(1) purposes applied to Section 12(2).¹⁷³ However, the Second Circuit had recently ruled in *Capri v. Murphy*,¹⁷⁴ that based on prior Second Circuit precedent which held that the language of sections 12(1) and 12(2) had identical meanings,¹⁷⁵ a section 12(2) defense should be analyzed under the *Pinter* framework.¹⁷⁶

The district court also took note of the *Wilson* decision.¹⁷⁷ It stated that the *Wilson* court read *Pinter* to say that liability cannot be extended to persons who only have a "collateral role" in the preparation of a securities issue. Instead, to be liable under section 12, a person must have been involved in the actual solicitation of sales and have been motivated by the desire to make a profit.¹⁷⁸ In the instant case, attorney Pillai and his firm produced affidavits indicating that they had no involvement in the deal that would cause them to violate section 12.¹⁷⁹ Since plaintiffs could only bring conclusory allegations of the attorney defendants' potential involvement, no reasonable jury could find that they had violated section 12.¹⁸⁰ Therefore, the district court granted summary judgment to attorney Pillai and his law firm.¹⁸¹

The *Ackerman v. Schwartz*¹⁸² case concerned a fraudulent tax credit scheme. In 1983 and 1984, Gary Van Waeyenberghe and Carl Leibowitz promoted a tax shelter investment involving ethanol manufacturing.¹⁸³ In exchange for each \$10,000 invested, an investor would receive an instant tax credit of \$20,000, a \$10,000 deduction, and the opportunity to profit from the business.¹⁸⁴ An attorney, Howard Schwartz, prepared an opinion letter stating that investors would be entitled to these benefits under the Internal Revenue Code.¹⁸⁵

More than 100 persons invested in this scheme which turned out to have several problems. First, the IRS disallowed the credits and deductions.¹⁸⁶ Secondly, Van Waeyenberghe and Leibowitz illegally

173. *Id.* at 1291-92.

174. 856 F.2d 473, 478 (2d Cir. 1988). *Capri* does not involve a professional such as an attorney or accountant, and full discussion of it is therefore beyond the scope of this Article.

175. *Schillner v. H. Vaughan Clarke & Co.*, 134 F.2d 875 (2d Cir. 1943).

176. *Sellin v. Rx Plus, Inc.*, 730 F. Supp. 1289, 1292 (S.D.N.Y. 1990).

177. *Id.* For a discussion of *Wilson* see section III.A *supra*.

178. *Id.*

179. *Id.* at 1294.

180. *Id.* at 1293-94.

181. *Id.* at 1294.

182. 947 F.2d 841 (7th Cir. 1991).

183. *Id.* at 842.

184. *Id.*

185. *Id.* at 843.

186. *Id.* at 842-43.

siphoned cash from the deal, and they both later pleaded guilty to assorted crimes in connection with this scheme.¹⁸⁷ Lastly, it turned out that the ethanol manufacturing equipment, valued in the offering documents at \$100,000, was actually worth about \$5,000.¹⁸⁸

With the money gone and Van Waeyenberghe and Leibowitz in jail, the investors sued Schwartz, the attorney who prepared the opinion letter. This letter made several misrepresentations: that the several corporations involved in the deal were unaffiliated when, in fact, they were all shells owned by or affiliated with Van Waeyenberghe and Leibowitz; that the equipment was worth \$100,000; that the equipment would be in use by the end of 1983; and that the IRS would be "unable to deny" the credits and deductions to investors.¹⁸⁹ Schwartz and one of his associates disputed who had made the "due diligence" inquiry regarding these facts, but this inquiry was not made, even though the opinion letter arguably implied that all necessary investigation had been conducted.¹⁹⁰

The court of appeals described the complaint filed in the case as "implausible" and filled with references to inapplicable statutes.¹⁹¹ The district court had previously deleted many claims and granted summary judgment for Schwartz based on the 1983 transactions.¹⁹² As for the 1984 transactions, the district court eventually concluded, *inter alia*, that Schwartz was not a "seller" under section 12, and plaintiffs appealed.¹⁹³

Initially, the court of appeals discussed the scope of section 12, and then cited *Pinter* for the proposition that although section 12(1) covers "sellers" who are not in privity with the purchaser, it does not reach persons, such as attorneys, who facilitate sales but are not "sellers."¹⁹⁴ The court went on to state that plaintiffs' claim that Schwartz could still be liable under section 12(2) foundered on the same rock because the statute does not permit differentiation between sections 12(1) and 12(2).

Both § 12(1) and § 12(2) identify the person who "offers or sells a security" as the one potentially liable. "Offer" and "sell" are defined terms in the '33 Act . . . and cannot mean one thing in § 12(1) and something else in § 12(2). Under *Pinter* a lawyer is not a seller, and the investor is not "the person purchasing such security from" a lawyer. Plaintiffs' theory that Schwartz is a seller because his opinion letter played an important role in making the units market-

187. *Id.* at 843.

188. *Id.*

189. *Id.*

190. *Id.* at 843-44.

191. *Id.* at 844.

192. *Id.*

193. *Id.* The district court also held that Schwartz did not have the state of mind necessary for liability under section 10(b) of the Securities Exchange Act of 1934.

Id.

194. *Id.*

able is just another version of the proposition that § 12 covers anyone whose participation is a "substantial factor" leading to the transaction. *Pinter* considered and rejected [this] approach to liability under § 12.¹⁹⁵

The court of appeals further noted that the structure of the 1933 Act supported this conclusion. Section 11 of that law creates liability for issuers, underwriters, and anyone who signs a registration statement containing a materially false or misleading statement.¹⁹⁶ Statutory defenses such as due diligence, reliance on expert opinion, or lack of causation are available to everyone but the issuer.¹⁹⁷ Section 12, on the other hand, is harsher and lacks any reference to such defenses.¹⁹⁸ If the terms "seller" and "purchaser" in section 12 were read as broadly as Ackerman and the other plaintiffs would like, section 11 would be entirely ignored by potential plaintiffs. Therefore, by limiting the scope of section 12, the Congressional intent to give professionals, such as attorneys and accountants, access to those defenses would be upheld.¹⁹⁹

Ackerman and the other plaintiffs argued that Schwartz should at least be held liable as an aider and abettor.²⁰⁰ The court rejected this argument for the same reason that it rejected a broad reading of section 12: it would upset the framework of the 1933 Act to allow for liability for aiding and abetting.²⁰¹ Therefore, "there is no liability for aiding and abetting a violation of § 12."²⁰² Thus, the court of appeals affirmed, *inter alia*, the district court's dismissal of the section 12 claims against Schwartz.²⁰³

D. What Constitutes Solicitation?

The *Wilson* and *Moore* cases are significant in that they provided the first indication as to how the new seller status standard will be applied to attorneys and accountants. In *Pinter* the Supreme Court expressly rejected the substantial factor test as the preferred standard for establishing seller status. This test had the effect of bringing within the liability umbrella a number of professionals performing routine duties and acting as merely collateral participants in the security issuance process. By rejecting the substantial factor test the Supreme Court has sent a clear message that the reach of the 1933

195. *Id.* at 844-45.

196. *Id.* at 845.

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.* In reaching this conclusion, the court discussed several cases, including *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 942 (7th Cir. 1989) and the *Wilson* decision discussed in section III.A *supra*.

202. *Ackerman v. Schwartz*, 947 F.2d 841, 845 (7th Cir. 1991)(citations omitted).

203. *Id.* at 849.

Act is to be limited to those individuals and professionals more closely connected with the actual sales and purchase transaction. In referring to the potential liability of accountants and lawyers under the substantial factor test, the Supreme Court notes that the test would extend section 12 liability "to participants only remotely related to the relevant aspects of the sales transaction."²⁰⁴ In effect, the substantial factor test was in reality a "substantial participation" test grounded in the concept of proximate causation.

By retreating from the substantial factor test to a standard driven more by the act of solicitation, securities professionals such as accountants and lawyers are in a better position to perform their roles without having to be overly concerned about potential liability as sellers. The *Moore* court stated that the providing of professional services is an activity which should be made separate and distinct from the solicitation effort.²⁰⁵ The court went on to draw a distinction between the act of solicitation and assisting in the solicitation effort.²⁰⁶ It concluded that the attorneys involved in that case had merely assisted in the sales transaction and, therefore, could not be deemed to have solicited purchases.²⁰⁷

This analysis is a perfect example of a situation where the substantial factor test might have imposed liability on the attorneys as collateral participants despite their failure to have actually solicited the purchase for a personal pecuniary gain. This conclusion is buttressed by the court's conclusion that a wide variety of activities engaged in by the attorneys could not be used to conclusively determine that they had engaged in solicitation. These activities included permitting professional opinions to be included in promotional materials and allowing their names to be used on the promotional literature as general counsel to the firm.²⁰⁸

The *Wilson* court reached a similar conclusion that attorney and accountant liability is further restricted as opposed to expanded by the *Pinter* decision relative to the substantial factor test:

After *Pinter*, some persons who are not in privity with the plaintiff but who would have been collateral participants under our prior case law are now not statutory sellers because they did not solicit the sales in question. Such persons are no longer subject to any liability under Section 12.²⁰⁹

Ruffa & Hanover were then deemed to fall within this category of participants and held not liable as solicitors for having completed the mere "ministerial act of mailing a copy of the private placement mem-

204. *Pinter v. Dahl*, 486 U.S. 622, 651 (1988).

205. *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 537 (9th Cir. 1989).

206. *Id.*

207. *Id.*

208. *Id.*

209. *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989).

orandum" to potential purchasers.²¹⁰ The *Wilson* court characterized the law firm's actions as "usual professional functions" and that the Supreme Court's primary concern was aimed more at individuals such as brokers who are more correctly viewed as acting on behalf of the seller.²¹¹

The three post-*Wilson* and *Moore* cases²¹² illustrate just how difficult a task it is for plaintiffs to assign liability to attorneys, accountants, or other professionals under section 12(2) of the 1933 Act. The *Royal American Managers* case stresses the requirement that the professional be someone who actually passes title to or directly solicits the sale from a purchaser. Even deep involvement, such as being an officer or director of one of the entities involved or offering expert opinions crucial to closing a sale, will not be sufficient to make a professional a "seller." It would be difficult for any professional to be any more involved in a sale of securities than attorney Dolman was without actually performing the sales or solicitation himself, yet Dolman still was not held liable under section 12(2).

Sellin v. Rx Plus involves a potentially very serious situation, one in which the professionals, an attorney and his firm, were alleged to have intentionally prepared a deficient placement memorandum. However, the *Sellin* court takes an important step that the Supreme Court in *Pinter* declined to consider, in that it states directly that the definitions and standards applied to section 12(1) and section 12(2) ought to be the same. This reasoning insulated the defendant attorneys in that case, and is an important safeguard for professionals involved in the securities industry. *Sellin* also illustrates how difficult it is for plaintiffs to overcome the threat of summary judgment in section 12(2) cases. Mere allegations, without evidence beyond the allegedly deficient documents themselves, are apparently inadequate, particularly in light of the defendant professionals' affidavits concerning their activities. Professionals should learn from *Sellin* to thoroughly document the extent of their involvement in securities offerings in order to prevent future questions regarding their participation.

Ackerman v. Schwartz is an excellent example of several aspects of section 12(2) litigation involving professionals. First, like *Royal American Managers*, it illustrates that even significant involvement in an offering, such as preparing a deficient opinion letter without conducting sufficient investigation, is not enough to trigger section 12(2) liability. Such conduct may bring a professional under other sections of the 1933 or 1934 Acts, or may expose her or him to charges of malpractice, but is insufficient to establish section 12(2) liability. Second, the *Ackerman* court provides a helpful analysis regarding the inter-

210. *Id.*

211. *Id.*

212. See *supra* section III.C.

play between section 12 and other sections of the Act, and uses that interplay as a justification for shielding professionals from liability. Professional defendants in future section 12 cases should be prepared to make similar arguments. Third, *Ackerman* stresses the point made in the Second Circuit's *Wilson* decision that aiding and abetting liability no longer applies to section 12 litigation.

IV. THE ACCOUNTANT'S ROLE IN PUBLIC AND PRIVATE PLACEMENTS

A. Professional Accounting Standards

The preparation of financial reports is the genesis of an accountant's liability, and their preparation is governed by a body of auditing standards.²¹³ Statement on Auditing Standards (SAS) No. 1, clearly provides that the audit goal is the expression of an opinion on the representational fairness of the financial statements. The opinion is the result of the auditor's judgement, not a statement of fact, and is a view that must be based upon sound reasoning and the application of Generally Accepted Accounting Principles (GAAP).²¹⁴ Although management's primary responsibility for the financial statements is clearly distinguished, auditors cannot remove themselves from their opinion or the responsibility that emanates from it.²¹⁵ Additionally, public offerings which include financial statements prepared by or audited by the accountant fall under the same umbrella of professional responsibility and conduct standards.

Standards of auditing performance are promulgated for the profession by the American Institute of Certified Public Accountants (AICPA). First, Generally Accepted Auditing Standards (GAAS) address basic auditor performance,²¹⁶ while the *Code of Professional Conduct* governs ethical performance considerations and is designed to promote public trust and confidence.²¹⁷ The GAAS include ten Standards that form the professional foundation for the practitioner

213. Kathy Williams, *Lawsuit Increase*, MANAGEMENT ACCOUNTING, Oct. 1990, at 16.

214. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 1, § 110 (Am. Inst. of Certified Pub. Accountants 1972), reprinted in 1 AICPA PROFESSIONAL STANDARDS (CCH) AU § 150 (1991). This code provides: "The objective of the ordinary audit of financial statements by the independent auditor is the expression of an *opinion* on the *fairness* with which they present fairly, in all material respects, financial position, results of operations, and its cash flows in conformity with *generally accepted accounting principles*." *Id.* (emphasis added).

215. *Id.*

216. *Id.*

217. CODE OF PROFESSIONAL CONDUCT, (Am. Inst. of Certified Pub. Accountants (1988)(amended 1992)), reprinted in 2 AICPA PROFESSIONAL STANDARDS (CCH) AU §§ 50-591 (June 1, 1993).

and which are broken down into three categories: General Standards, Standards of Field Work, and Standards of Reporting.²¹⁸

The General Standards pertain to the auditor as an individual, and initially require that the auditor be technically competent and maintain independence. Any factor that even appears to indicate a dependence or relationship between the client and the auditor must be avoided, and although each standard is significant, particular culpability can be generated by General Standard number 3 which calls for "[d]ue professional care."²¹⁹ Due care requires the typical standard of work that could be expected of the reasonable and prudent accountant. This has been interpreted to include adequately training staff, following the promulgated standards and working under adequate supervision with proper review of all completed work. It does not insure an infallibility based upon errors in judgment, but it does prohibit dishonesty, bad faith, and negligence. Whether this standard requires

218. General Accepted Auditing Standards:

General Standards

1. The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the audit and the preparation of the report.

Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

Standards of Reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.

219. *Id.*

the auditor to recognize an obligation to the complete spectrum of financial statement users is questionable, but this is certainly the position advanced by those investors seeking to impose liability on the auditor via section 12.

The Standards of Field Work pertain to the management and operation of the audit. From the outset, all work must be adequately planned and supervised. The second field work standard requires an analysis of the internal control system, which includes all of the rules, regulations and practices that govern the audited firm's accounting system. The field work standards insure that firm assets are protected, management policies are followed, the accounting data are accurate, and only authorized transactions are permitted to occur. An auditor usually relies on the internal control system, rather than examining every accounting and financial transaction. A systematic process of evaluation is used to verify the strength and reliability of the internal control system and the resulting financial data produced by it.

The Standards of Reporting focus on the content of the report. The initial reporting standard requires the auditor to disclose any departures from Generally Accepted Accounting Principles. Few auditors would permit departures from GAAP although the standards permit such departures when the auditor can justify them. However, since the burden of proof for these deviations falls upon the auditor and her firm, departures from reporting standards are seldom observed. The second reporting standard requires disclosure of any inconsistent application of generally accepted accounting principles. To the non-accountant, the sanctioning of deviations from GAAP may appear to be contradictory. However, GAAP does permit the application of conflicting principles which, when individually and consistently applied, will not degrade the integrity of the financial statements. Disclosure of these conflicts, along with their related effect on the financial statements, is required.

The third reporting standard requires "informative disclosures" of all material financial information. The major risk for the auditor is the failure to disclose or an inadequate disclosure of material information as required by GAAP. Informative disclosures are typically included in the footnotes to the financial statements and may not always be fully appreciated by non-accountants. Footnotes must be straightforward, provide a concise statement of the facts, and not present any opinions. The guiding legal standard for footnote content is "materiality," and while any material item which may affect the financial statement must be disclosed, there is sufficient litigation to establish that there is often a significant difference of opinion as to what constitutes "material information."

An additional consideration regarding this standard is the protection of client confidences. The auditor must not disclose confidential information which may erode the client's confidence in the auditor and which may cause the client to restrict free access to required information. This places the auditing professional in a precarious legal situation since auditors do not enjoy the confidentiality protection afforded attorneys and their clients.

B. Accountant's Code of Professional Conduct

The *Code of Professional Conduct* contains both rules which are more definite,²²⁰ and principles which are more equivocal.²²¹ Consequently, it allows considerable latitude for interpretation by the public and the judiciary. For example, in the first Article, an auditor must exercise "sensitive professional and moral judgements" for all their activities. Additional Articles continue in a similar vein as they delineate the qualities for professional service to the public (Article 2),

220. CODE OF PROFESSIONAL CONDUCT, *supra* note 217, at ET §§ 90-591.

221. CODE OF PROFESSIONAL CONDUCT, *supra* note 217, at ET §§ 50-57. The Principles of Professional Conduct are as follows:

Article I - Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgements in all their activities.

Article II - The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

Article III - Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

Article IV - Objectivity and Independence

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

Article V - Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

Article VI - Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

Id.

mandate that public confidence be maintained (Article 3), require freedom from conflicting interests (Article 4), promote public trust and independence both in fact and appearance (Article 4), and require technical competency (Article 5).

Fortunately, the *Code* is amplified and illustrated by Interpretations of Rules of Conduct and Ethical Rulings. These clarifications provide examples using hypothetical fact patterns that the auditor can consider when confronted with an ethical problem. The Ethical Rulings cover subjects such as the effect on independence that results from honorary directorships and trusteeships bestowed upon auditors, as well as the percentage of an auditor-investor interest that will constitute a material amount thereby affecting the accountant's independence and calling his impartiality into question.

C. The SEC, The Auditor and New Security Offerings

As part of the registration process for a new security offering, auditors are frequently called on to write letters based upon the accounting and auditing requirements of the Securities Act of 1933. As a result of conferences with clients, underwriters, and legal counsel, the audit report will make comments in the form of a "comfort letter." The process does not involve a full audit but rather a reasonable investigation. Unfortunately, the definition of "reasonable investigation" has not been authoritatively established, hence the auditor is operating under a higher level of risk. These letters normally comment on auditor independence, financial statement compliance with Securities Act registration requirements, changes in selected financial statement items during the period subsequent to the preparation dates, and tables, statistics, and other financial information required for registration. Considering the potential liability associated with preparation of these "comfort letters," the prudent auditor operating under the "due care" standard should carefully read and follow the guidelines provided in Statement of Auditing Standards (SAS) No. 72.²²²

Auditor work related to a new offering is also governed by Securities and Exchange Commission (SEC) Regulations. Regulation S-X provides clear definitions for the qualification of both certified and public accountants and for accountants' reports.²²³ Whether an individual qualifies as a certified or public accountant is dependent upon the requirements set forth by his or her particular state licensing agency.²²⁴

222. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 72 (Am. Inst. of Certified Pub. Accountants 1993), reprinted in 1 AICPA PROFESSIONAL STANDARDS (CCH) AU § 634 (June 1, 1993).

223. Regulation S-X, SEC Accounting R. (CCH) Reg. §§ 210.2-01 to 210.2-051 (Feb. 1991). Regulation S-X is also found in 17 C.F.R. § 210 (1994).

224. *Id.* § 210.2-01(a). Section 210.2-01(a) provides:

Additionally, the Regulations comment on when an accountant's independence can be called into question, and this point is certainly germane to the "seller" issue under section 12(2). An accountant will not be considered independent if there is any direct financial interest or any material, indirect financial interest between the parties. Materiality is not defined although the Commission will not be limited to the case in question while evaluating the independence issue, but rather will look to any "evidence bearing on all relationships between the accountant and that person."²²⁵ Certain individuals, such as pro-

The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

Id.

225. *Id.* at § 210.2-01(b) & (c). Section 210.2-01(b) & (c) provides:

- (b) The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will be *considered not independent* with respect to any person or any of its parents, its subsidiaries, or other affiliates
 - (1) in which, during the period of his professional engagement to examine the financial statements being reported on or at the date of his report, he, his firm, or a member of his firm had, or was committed to acquire, any direct financial interest or any material indirect financial interest;
 - (2) with which, during the period of his professional engagement to examine the financial statements being reported on, at the date of his report or during the period covered by the financial statements, he, his firm, or *a member of his firm was connected as a promoter, underwriter, voting trustee, director, officer, or employee*. A firm's independence will not be deemed to be affected adversely where a former officer or employee of a particular person is employed by or becomes a partner, shareholder or other principal in the firm and such individual has completely disassociated himself from the person and its affiliates and does not participate in auditing financial statements of the person or its affiliates covering any period of his employment by the person. For the purposes of § 210.2-01(b), the term "member" means
 - [i] all partners, shareholders, and other principals in the firm,
 - [ii] any professional employee involved in providing any professional service to the person, its parents, subsidiaries, or other affiliates, and
 - [iii] any professional employee having managerial responsibilities and located in [the engagement office] or other office of the firm which participates in a significant portion of the audit.
- (c) In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, *including evidence bearing all relationships between the accountant and that person or any affiliate thereof*, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

motors, are specifically excluded as independent parties.²²⁶ Other relationships which will preclude meeting statutory independence include: underwriter, voting trustee, director, officer, or employee.²²⁷ For purposes of determining independence, membership in a firm includes all partners, shareholders, other principals, any professional providing services to the client, or a professional with managerial responsibilities who is located within the same or participating office of the firm.²²⁸

As for the content and quality of accountant reports, the regulations require that it be prepared in good form with all the associated titles, dates, the auditor's name and address, and a list of statements covered.²²⁹ A clear statement of opinion is required with references to GAAP and GAAS, and any exceptions must be explicitly noted and explained. These Commission requirements mirror the professional standards set forth by the AICPA.²³⁰

Id. (emphasis added).

226. *Id.*

227. *Id.*

228. *Id.*

229. *Id.* § 210.2-02. Section 210.2-02 provides:

(a) *Technical requirements.* The accountant's report:

- (1) Shall be dated;
- (2) shall be signed manually;
- (3) shall indicate the city and State where issued; and
- (4) shall identify without detailed enumeration the financial statements covered by the report.

(b) *Representations as to the audit.* The accountant's report:

- (1) shall state whether the audit was made in accordance with generally accepted auditing standards; and
- (2) shall designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case, which have been omitted, and the reasons for their omission. Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (c) of this section.

(c) *Opinion to be expressed.* The accountant's report shall state clearly:

- (1) The opinion of the accountant in respect of the financial statements covered by the report and the accounting principles and practices reflected therein; and
- (2) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have a material effect on the financial statements.

(d) *Exceptions.* Any matters to which the accountant takes exception shall be clearly identified, the exception thereto specifically and clearly stated, and, to the extent practicable, the effect of each such exception on the related financial statements given. (See Section 101 of the Codification of Financial Reporting Policies.)

Id.

230. See *supra* sections IV.A and IV.B.

Finally, in addition to the promoter exclusion outlined above, SEC regulations expand upon the definition of a "promoter" by requiring evidence of a clear action or initiative to found and organize a business enterprise.²³¹ A threshold benefit test is set at a minimum of ten percent of the offering sale proceeds, but this limitation can be waived if payment to the auditors is constructed as an underwriting commission. Thus, auditors qualifying under this regulation as underwriters would not be considered promoters.²³²

V. CONCLUSION

As disenfranchised investors sought to develop new causes of action under the securities statutes, the liability of collateral participants, such as attorneys and accountants, has not really been in question when that liability is proven pursuant to section 10(b) of the 1934 Act and Rule 10b-5. However, when plaintiffs allege fraudulent conduct by attorneys in the registration process or selling of a securities offering as constituting a violation of the 1933 Act, section 11 of that statute affords a variety of statutory defenses including due diligence, reliance on expert opinion, and lack of causation. These are classic reasonable person defenses in the vein of common law negligence and are available to all defendants except the issuer.

Since attorneys and accountants are not the issuers in any of these cases, the preferred approach by plaintiffs is to allege conduct rising to the level of "seller" status and which is sufficiently egregious to constitute a violation of section 12. This denudes the attorneys of the section 11 defenses and turns the action into a matter of potential strict liability, a result that Congress knowingly endorsed when it constructed these liability provisions. The problem for plaintiffs has been that the federal courts have not been as willing to expand the concept

231. 17 C.F.R. § 210.1-02(r) (1994). Section 210.1-02(r) provides: The term *promoter* includes —

- (1) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes the initiative in founding and organizing the business or enterprise of an issuer;
- (2) Any person who, in connection with the founding and organizing of the business or enterprise of an issuer, *directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of securities.* However, a person who receives such securities or proceeds either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter within the meaning of this paragraph if such person does not otherwise take part in founding and organizing the enterprise.

Id. (emphasis added).

232. *Id.*

of "seller" status as they have in interpreting applications of RICO or even common law negligence to malfeasance in the securities arena.

The basis of this federal court position is rooted in the *Pinter* decision and the Supreme Court's direct rejection of the "substantial factor" test. The Court noted that collateral participants ought to be adjudged to be "sellers" depending on their relationship with seller and buyer, rather than focusing on their motivation. The *Moore* and *Ackerman* courts, in applying this precedent, correctly pointed out the differences in actions seeking strict liability under section 12 and those cases alleging misconduct not envisioned as falling within the legislative intent underpinning of the seller liability provision. In such cases, it now must be established that collateral participants, such as attorneys and accountants, have actually participated in the act of solicitation before "seller" status will hold. Otherwise they cannot be stripped of their right to statutory defenses under section 11.

This refusal on the part of the federal courts to expand attorney and accountant liability should not go unnoticed, nor should it be taken for granted by professionals involved in the registration and security sales process. There is still substantial room for professional malpractice under the 1933 Act outside the context of section 12, and collateral participants must insure that their conduct conforms to standards that are generally accepted within their profession. Professionals have everything to gain in avoiding even the appearance of impropriety rising to the level of malpractice or fraud in securities cases. Despite *Pinter* and its subsequent case line, it should be expected that lawsuits filed pursuant to the 1933 Act will continue to include the "seller" status claim in order to gain leverage in the pre-trial process. Even where these claims are defeated at the motion stage, the injury to personal reputation and the financial cost will most certainly be significant.